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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-595

FRANK E. MOTT and MARY R. WILLIAMS, Executors of the Last Will and Testament of Walter C. Teagle,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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In the

Supreme Court of the United States

October Term, 1972

No. .....

Frank E. Mott and Mary R. Williams, Executors of the Last Will and Testament of Walter C. Teagle,

Petitioners,

—v.—

United States of America,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioners pray that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Claims entered in this proceeding on July 14, 1972.

Opinion Below

The opinion of the Court of Claims is officially reported at 462 F.2d 512 (Ct. Cl. 1972) and is set forth herein as Appendix A (1a-15a).

Jurisdiction

The judgment of the United States Court of Claims was rendered on July 14, 1972; judgment was entered on the same date. This Petition for Certiorari was filed within ninety days of that date. The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1255(1).

Question Presented

The sole question in this proceeding is whether an estate is entitled to the distribution deduction from gross income provided by Section 661(a) of the Internal Revenue Code of 1954, as amended (herein "Code") for amounts of principal which it distributes to a qualified charitable beneficiary.

Statute and Regulation Involved

Set forth in full in Appendix B (16a-19a)

Internal Revenue Code of 1954, as amended, 26 U.S.C., Vol. 6, at 6599-6604 (1971):

Section 642(c)(1)
Section 661(a)
Section 662(a)
Section 663(a)

Treasury Regulation, 26 C.F.R., Part 1 (§1.641) at 52 (1971):

Treas. Reg. Section 1.663(a)-2

Statement of Case

Petitioners are the Executors of the Last Will and Testament of Walter C. Teagle. For the taxable years 1963, 1964 and 1965, Petitioners made payments of $13,165,575.75, $405,379.02, and $375,000.00, respectively, out of the principal of the Estate to The Teagle Foundation, Incorporated, a qualified charitable organization, in partial satisfaction of a general pecuniary bequest.

Petitioners timely filed amended United States Fiduciary Income Tax Returns for the 1963 and 1964 taxable years and a Form 843, Claim, for the 1965 taxable year, claiming distribution deductions under Section 661(a) of the Code for these payments and showing overpayments of tax. That portion of the overpayments claimed which was attributable to these distribution deductions was disallowed by the Internal Revenue Service.

On September 22, 1969, Petitioners filed a Petition with the United States Court of Claims, petitioning for a refund of the taxes and interest and invoking the jurisdiction of the Court under Title 28, United States Code, Section 1491. Subsequent to the filing of Respondent's Answer and the filing of a complete Stipulation of Facts, Petitioners and Respondent filed cross-motions for summary judgment in this matter. By a decision rendered by the Court of Claims on July 14, 1972, Respondent's motion for summary judgment was granted, Petitioners' motion for summary judgment was denied, and Petitioners' Petition was dismissed. In reaching its decision, the court below held that Treas. Reg. Section 1.663(a)-2 is dispositive of the issue in this proceeding and operates to preclude a distribution deduction for distributions to charities. (10a and 14a).

REASONS FOR GRANTING WRIT

I.

The decision below conflicts with established principles of statutory construction and, if permitted to stand, will hinder the just administration of the tax laws.

Petitioners claimed a distribution deduction from the gross income of the Estate for amounts of principal which were distributed to a qualified charitable organization.

Such a distribution deduction is expressly permitted by Section 661(a) of the Code, which allows as a deduction in computing the taxable income of an estate or trust, to the extent of distributable net income, amounts of income for the taxable year required to be distributed currently and, pursuant to paragraph (2) of that provision, "any other amounts properly paid or credited or required to be distributed for such taxable year . . . ."

Three exceptions to the allowance of a distribution deduction under Section 661(a) of the Code are specified in Section 663 of the Code. Petitioners contended and the court below concurred that the exceptions specified in Section 663 of the Code are not applicable in the instant case. (8a and 9a).

Section 663(a)(2) of the Code includes as an exception "Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642 (c). . . ."[1] The first sentence of Treas. Reg. Section

[1] Section 642(c) of the Code provides for a deduction for amounts of "gross income" paid or permanently set aside for charitable

1.663(a)-2[2] provides that amounts specified in Section 642 (c) of the Code and "allowable as a deduction" under that provision are encompassed by Section 663(a)(2) of the Code and are therefore not deductible as distribution deductions. The second sentence of Treas. Reg. Section 1.663 (a)-2 proceeds by administrative fiat to assert that amounts paid for charitable purposes are deductible "only as provided" in Section 642(c) of the Code.

Despite the clear and unambiguous language of Section 661 and Section 663 of the Code, and the consistent and reasonable interpretation thereof set forth in the first sentence of Treas. Reg. Section 1.663(a)-2, the court below has seized upon the language in the second sentence of the Regulation as its rationale for disallowing Petitioners' claimed deductions in the instant case. This sentence of the Treasury Regulation, which the court below held is dispositive of the issue in this proceeding, is in direct contradiction to Section 661 and Section 663 of the Code.[3]

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purposes and is inapplicable in this proceeding as the distributions in issue constitute amounts of principal.

[2] Treasury Reg. Section 1.663(a)-2 provides in full as follows: "Any amount paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) and *which is allowable* as a deduction under that section is not allowed as a deduction to an estate or trust under section 661 or treated as an amount distributed for purposes of determining the amounts includible in gross income of beneficiaries under section 662. Amounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates or trusts *only as provided* in section 642(c). For purposes of this section the deduction provided in section 642(c) is computed without regard to the limitation provided by section 681 (concerning unrelated business income and prohibited transactions)." (emphases added).

[3] The second sentence of Treas. Reg. Section 1.663(a)-2 also directly contradicts the first sentence of the same Regulation. More-

It is a well-settled principle of law, long enunciated by this Court, that a regulation promulgated by an administrative agency which is inconsistent with a Congressional statute is null and void:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch* v. *Tilden Produce Co.*, 265 U.S. 315, 320-322; *Miller* v. *United States*, 294 U.S. 435, 439-440, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. *International Ry. Co.* v. *Davidson*, 257 U.S. 506, 514." *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134, 135 (1936).

A Treasury Regulation exceeding the legislative intent of the statute which it purports to interpret is invalid. *See Commissioner* v. *Acker*, 361 U.S. 87, 92 (1959); *United States* v. *Calamaro*, 354 U.S. 351, 359 (1957); *Helvering* v. *Credit Alliance Corp.*, 316 U.S. 107, 113 (1942); *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 48 (1939); *M. E. Blatt Co.* v. *United States*, 305 U.S. 267, 279 (1938); *Koshland* v. *Helvering*, 298 U.S. 441, 445 (1936).

The Court of Claims attempts to lend authority to Treas. Reg. Section 1.663(a)-2 by finding ". . . an *implied* Con-

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over, Treas. Reg. Section 1.663(a)-2 interprets Section 663 of the Code, which the court below held inapplicable in the instant proceeding. (8a and 9a).

gressional intent to prevent all charitable distributions, whether or not deductible under Section 642(c), from entering into the operation of the distribution rules." (emphasis added). (12a). The court below extrapolates this "implied" intent through analysis of the interrelationship of Sections 642(c), 661 and 662[4] of the Code. The court, however, ignores the fact that Congress has expressly stated, in Section 663(a)(2) of the Code, its intent regarding the availability of a distribution deduction for distributions to charities. Congress provided therein that only amounts qualifying for deduction under Section 642(c) of the Code are excluded from the distribution deduction provided by Section 661 of the Code. Clearly, a court may not sustain an invalid regulation through a finding of "implied" Congressional intent where Congress has stated its express intent in the statutory provisions.[5]

The Court of Claims would, in effect, amend the Code on the grounds that Congress should have had a different intention than that which was expressed. *Helvering* v. *Rebsamen Motors, Inc.*, 128 F.2d 584, 588 (8th Cir. 1942). The court below is not at liberty, however, to alter a statutory provision to effect a purpose which does not appear

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[4] Section 662 of the Code provides that amounts deductible under Section 661 of the Code are to be included in the gross income of the respective distributee.

[5] Not only does the court below rely upon "implied" Congressional intent, but it holds that the application of this "implied" intent is restricted to the facts of the instant case. To quote:

> "The Government's position seems to be correct in the context of this case, but we do not hold that it is a general rule which may be applied in every conceivable situation that may arise under the provisions of the Code here considered. We think it is sufficient to say that, under the facts of this case, the Government's position accords with the general intent of Congress in enacting the distribution rules. . . ." (12a).

on the face of the statute. *See Hanover Bank* v. *Commissioner*, 369 U.S. 672, 687 (1962); *Crooks* v. *Harrelson*, 282 U.S. 55, 60 (1930).

This principle was recently affirmed by this Court in *Commissioner* v. *Brown*, 380 U.S. 563 (1965), involving a so-called "bootstrap" sale and leaseback with a tax-exempt organization, wherein the Court stated:

> ". . . [I]f the Commissioner's approach is intended as a limitation upon the tax treatment of sales generally, it represents a considerable invasion of current capital gains policy, a matter which we think is the business of Congress, not ours.
>
> The problems involved in the purchase of a going business by a tax exempt organization have been considered and dealt with by the Congress. . . . [I]t has responded, if at all, with precise provisions of narrow application. We consequently deem it wise to 'leave to the Congress the fashioning of a rule which, in any event, must have wide ramifications.' *American Automobile Assn.* v. *United States*, 367 U.S. 687, 697." 380 U.S. at 579.[6]

Like *Commissioner* v. *Brown*, the instant case also involves precise provisions of narrow application; the court below should have exercised the same judicial restraint as did this Court in the *Brown* decision.

In sum, the decision of the Court of Claims directly contravenes the clear and simple provisions of the Code. The court below has violated fundamental principles of statutory construction and its decision represents a subtle erosion of the legislative function. Absent review by this

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[6] Subsequent to this Court's decision in *Commissioner* v. *Brown*, Section 514 of the Code was amended to restrict sales and leasebacks with exempt organizations.

Court, the decision of the Court of Claims, the court of original jurisdiction, will become final. To ensure proper supervision of the Federal judiciary, a writ of certiorari should issue so that this Court may confirm the proper principles of statutory construction and rectify the clear error of the court below.

II.

The decision below conflicts with decisions in the Courts of Appeals for the Fourth and Ninth Circuits.

The court below would sustain Treas. Reg. Section 1.663(a)-2 on the basis of an "implied" Congressional intent to preclude a distribution deduction for payments to charities. In the opinion of the court below, Congress did not intend to provide for a distribution deduction to an estate, under the facts in the instant case, for distributions which are not taxed to the beneficiary. No such limitation, however, was acknowledged by Congress in either the statute or the legislative history. Moreover, two decisions of the Courts of Appeals have recognized distribution deductions where the distributions were not subject to tax in the hands of the beneficiary.

Estate of Tait v. *Commissioner*[7] involved distributions by an estate of pension payments to nonresident Canadian individuals, who were exempt from United States tax with respect to the payments by virtue of the United States-Canadian Tax Convention. The Tax Court, in the original *Tait* opinion, held that:

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[7] 49-2 U.S. Tax. Cas. ¶9359 (4th Cir. 1949) (not officially reported), *rem'g* 11 T.C. 731 (1948), *reconsidered in*, 9 T.C.M. 122 (1949), *acquiesced in*, 1950-1 Cum. Bull. 5.

> ". . . it is incumbent upon the fiduciary claiming the deduction to show that the amount sought to be deducted is includible in the net income of the beneficiary. . . ." 11 T.C. at 739.

On appeal to the Court of Appeals for the Fourth Circuit, the case was remanded to the Tax Court for reconsideration of this issue. Upon remand, the Tax Court reversed its original opinion with respect to this issue and held, without opinion, that a distribution deduction was available with respect to the distributions in issue. The Government subsequently acquiesced in this decision.

United States v. *Bank of America Nat'l Trust and Savings Ass'n*[8] also recognized a distribution deduction to an estate despite the fact that the beneficiary was not taxed on its share of the distributable net income. In the *Bank of America* case, an estate distributed corpus to the trustee of a testamentary trust who, pursuant to the terms of the testator's will, set aside the property for charitable purposes. The parties agreed that a distribution deduction under Section 661(a) of the Code was available to the estate for the distribution in issue. The distributee, however, paid no tax with respect to the distribution, as the court held that the distribution constituted income permanently set aside for charitable purposes so that a deduction for the full amount was available under Section 642(c) of the Code.

Despite the fact that the *Tait* and *Bank of America* cases were discussed at length in the Briefs for Petitioners and Respondent in the court below, the opinion of the Court

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[8] 326 F.2d 51 (9th Cir. 1963), *aff'g in part on this issue* 203 F. Supp. 152 (N.D. Cal. 1962).

of Claims failed to distinguish or even mention these cases. The inherent inconsistency between these decisions and the opinion in the instant case justifies the grant of certiorari to review the judgment below.

III.

This case presents an important issue affecting innumerable estates and should be resolved without further delay by this Court.

Aside from the clear error of the court below and the conflict of its decision with those of the Courts of Appeals, the decision warrants review by this Court in light of the significant effect of this decision upon the tax treatment of distributions by fiduciaries and the estate planning programs of individuals. The court below has extended the application of Sections 661 and 663 of the Code beyond the literal terms of the statutory provisions; the effect of the decision is to deny a distribution deduction to estates for all distributions of corpus to charity. Such distributions often represent substantial contributions; for example, in the instant case, the distributions to The Teagle Foundation, Incorporated for the taxable years in issue totalled $13,945,954.77; as a result of the Court of Claims decision, additional taxes in the total amount of $881,103.20 will have been paid by Petitioners on behalf of the Estate of Walter C. Teagle. Thus, the issue in this proceeding is clearly a matter of public interest and the decision of the court below, if allowed to stand, will have a substantial impact on fiduciaries, charitable organizations and their contributors. The wisdom and authority of this Court is necessary to resolve this issue.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Claims.

Respectfully submitted,

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October 9, 1972

APPENDIX A

Opinion of the Court of Claims

IN THE

UNITED STATES COURT OF CLAIMS

No. 390-69

(Decided July 14, 1972)

FRANK E. MOTT AND MARY R. WILLIAMS, EXECUTORS OF THE LAST WILL AND TESTAMENT OF WALTER C. TEAGLE v. THE UNITED STATES

Edward A. Vrooman for plaintiffs. *Harry F. Weyher,* attorney of record.

Allan C. Lewis, with whom was *Assistant Attorney General Scott P. Crampton* for defendant. *Philip R. Miller* and *Joseph Kovner,* of counsel.

Before COWEN, *Chief Judge,* DURFEE, *Senior Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, and KUNZIG, *Judges.*

ON PLAINTIFFS' MOTION AND DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

COWEN, *Chief Judge,* delivered the opinion of the court:*

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* This opinion contains all the essential facts as stipulated by the parties.

This tax case, apparently one of first impression, comes before the court on the parties' cross-motions for summary judgment. The issue is whether an estate is entitled to a deduction from its gross income, pursuant to Section 661(a)(2) of the Internal Revenue Code of 1954,[1] when it makes a distribution of corpus of an estate to a qualified charitable beneficiary pursuant to a general pecuniary bequest. We have concluded that the claimed deduction is not available.

The pertinent facts, which have been stipulated, are as follows: Walter C. Teagle died on January 9, 1962, leaving a gross estate in excess of $36,000,000. Under the terms of his will, two-thirds of the estate, after payment of debts, expenses, and specific bequests, was left to the Teagle Foundation, a tax-exempt charitable corporation. The residue of the estate, including all income earned during its administration, was left in trust for the benefit of Jane W. Teagle, an alternate life beneficiary, with specified remainders over.

The years involved in this suit are the estate's taxable years ending July 31, 1963, 1964, and 1965. During this period, the executors of the estate made the following payments out of the corpus of the estate in partial satisfaction of the bequest to the Teagle Foundation:

1963	$13,165,575.75
1964	405,379.02
1965	375,000.00

The executors also made several distributions of income to Jane during the administration period before the trust came into operation, including during the years involved here, a $100,000 payment in 1963.

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[1] See appendix for the provisions of Section 661 and other provisions of the Code referred to in this opinion.

In computing Mr. Teagle's taxable estate, the executors were allowed an estate tax deduction of $14,107,420.90 for the charitable bequest to the Teagle Foundation. They now assert that they are also entitled to a deduction, in computing the estate's taxable income for the years involved here, for the payments described above which they made in satisfaction of the charitable bequest. Briefly stated, they contend that such a deduction is permitted by the plain terms of Section 661(a)(2), which provides in pertinent part that:

> In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate * * * any * * * amounts properly paid * * * for such taxable year * * *.

The Government, while conceding that a literal reading of Section 661(a)(2) would permit plaintiffs to prevail, maintains that that section cannot properly be interpreted without reference to its purpose, and that when the provision is read in the context of the entire statutory scheme of Subchapter J of Chapter 1 of the Code, it is clear that the distribution to the charitable organization in this case cannot qualify for the deduction permitted by Section 661(a)(2).

Before reaching the merits of this case, we think it is important to summarize briefly some of the basic principles of Subchapter J which relate to distributions by estates. Since the enactment of the Revenue Act of 1913,[2] the value of "property acquired by gift, bequest, devise or inheritance"[3] has been excluded from gross income. The exclusion is not absolute, however, since income from such property, includ-

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[2] Revenue Act of 1913 § IIB, 38 Stat. 114.

[3] INT. REV. CODE OF 1954, § 102(a).

ing income realized by an estate during its administration,[4] is subject to tax.[5] Similarly, a bequest of *income* from property is not within the statutory exclusion.[6] It has therefore become necessary to develop a system of rules which would determine the proper amounts of estate income subject to tax and, more importantly for purposes of this case, a system which would determine who should bear the burden of that tax. In making this latter determination, Congress has adopted the "conduit principle" of taxing estates (and trusts as well), through which an estate is treated as a taxable entity and is taxed, in general, on income which it realizes but which it does not distribute, or is not deemed to have distributed, to its beneficiaries. Where income is distributed to a beneficiary, or is deemed to be so distributed, that income would not be taxable to the estate but instead would be taxable to the beneficiary, a result which is accomplished by permitting the estate a deduction for the amount of the distribution and by requiring the beneficiary to include that amount in his gross income. In this manner, the conduit principle serves to effectuate a Congressional policy to tax estate income once, and only once, by allocating the tax between estate and beneficiary.[7]

Under the present rules of Subchapter J, the allocation described above is accomplished through the combined op-

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[4] *See id.*, § 641(a).

[5] *Id.*, § 102(b)(1); *cf.*, Revenue Act of 1916 § 4, 39 Stat. 756.

[6] INT. REV. CODE OF 1954, § 102(b)(2); *cf.*, Irwin v. Gavit, 268 U.S. 161 (1925).

[7] *See generally* Holland, Kennedy, Surrey, & Warren, *A Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates—American Law Institute Draft*, 53 COLUM. L. REV. 316, 318 (1953); 6 MERTENS, LAW OF FEDERAL INCOME TAXATION § 36.01 (rev. ed. 1968); FERGUSON, FREELAND, & STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 382 *et seq.* (1970).

eration of the concept of "distributable net income," or "D.N.I.," and the statutory distribution rules applicable to estates and complex trusts, which are set out in Sections 661–63. With regard to distributable net income, we limit our discussion here to only a few salient aspects of that concept, since we previously examined it in detail in *Manufacturers Hanover Trust Co.* v. *United States*, 160 Ct. Cl. 582, 312 F. 2d 785, *cert. denied*, 375 U.S. 880 (1963). What is important to note here is that D.N.I., which is essentially the estate's taxable income (with some modifications), serves generally as a ceiling on the combined tax liability of the estate and beneficiary, and limits the amount taxable to the beneficiary and deductible by the estate.

In addition, we should also note that D.N.I. is expressed in terms of *taxable* income, and that in computing taxable income Section 642(c), in general, allows an estate (or trust) an unlimited charitable deduction for amounts of "gross income" which, pursuant to the governing instrument, is paid, permanently set aside, or to be used for charitable purposes. Thus, a charitable distribution which is deductible under Section 642(c) has the effect of reducing the maximum aggregate amount taxable to the estate and beneficiary because it reduces D.N.I.[4]

The distribution rules of Sections 661-63 provide the mechanism for allocating D.N.I. between estate and beneficiary. Since frequently an estate makes distributions to more than one beneficiary during a particular taxable year, and since some beneficiaries have greater rights to income than do others, the distribution rules provide for priorities of taxability by establishing what is known as the "tier system." Through this system, D.N.I. is allocated under Sec-

[4] However, first-tier beneficiaries are taxed under Section 662(a)(1) up to the estate's D.N.I. undiminished by the deduction provided in Section 642(c).

tion 662(a)(1) first to beneficiaries who have rights to current income, based upon a conclusive presumption that "any distribution is considered a distribution of the trust or estate's current income to the extent of its taxable income for the year."[9] By presuming that such distributions are income, Subchapter J eliminates the need for "tracing" the source of distributions, as was necessary under prior law, to determine what portion, if any, constitutes amounts of current income.[10]

After allocating D.N.I. among the "first-tier" beneficiaries described above, any D.N.I. remaining would be allocated among "second-tier" beneficiaries according to Section 662 (a)(2). Theoretically, all distributions except first-tier distributions fall within the second tier, which is defined as "all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year." The term "amounts," which is central to the controversy here, is broad enough to encompass non-first-tier distributions from either principal or income, whether of money or specific property. Again, this eliminates the necessity for tracing, since the statute assumes that second-tier distributions diminish whatever D.N.I. remains after allocations to first-tier distributees.

By defining second-tier distributions as any "amounts," the sweep of Section 662(a)(2) is so broad that, if left unqualified, bequests excluded under Section 102(a) could become taxable to beneficiaries under Section 662. To preserve the exemption for bequests, Section 663(a)(1) excludes from the operation of the distribution rules any amount which is not payable solely out of income and "which, under the terms of the governing instrument, is

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[9] S. Rep. No. 1622, 83d Cong., 2d Sess. 349 (1954).

[10] *Id., see* Int. Rev. Code of 1939, § 162(b).

properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than three installments." If a distribution meets these requirements, it will be considered a bequest excluded under Section 102(a). If it fails to meet them, it will be considered a bequest of income from property under Section 102(b)(2),[11] and will be taxed according to the distribution rules. Of course, the amount taxable under the distribution rules is circumscribed by the estate's D.N.I., so that amounts distributed in excess of D.N.I. would still be considered as a bequest excluded under Section 102(a), whether or not the distribution meets the specific requirements of Section 663(a)(1).[12]

A second modification to the distribution rules which is pertinent to this case is contained in Section 663(a)(2). It provides that "amounts" do not include "[a]ny amount paid or permanently set aside or otherwise qualifying for the [charitable] deduction provided in Section 642(c) • • • ." The purpose of this provision, as explained by the committee reports, is that "since the estate or trust is allowed a deduction under Section 642(c) for amounts paid, permanently set aside, or otherwise qualifying for the deduction provided in that section, such amounts are not allowed as an additional deduction for distributions, nor are they treated as amounts distributed for purposes of Section 662 in determining the amounts includible in gross income of the beneficiaries." [13]

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[11] *See* INT. REV. CODE OF 1954, § 102 (last sentence); Treas. Reg. § 1.102-1(d) (1956).

[12] It should be noted that the "throwback rules" of Section 665–69 do not apply to estates. Thus, current D.N.I. is the maximum taxable amount.

[13] S. REP. No. 1622, 83d Cong., 2d Sess. 354 (1954). *See also* H.R. REP. No. 1337, 83d Cong., 2d Sess. A205 (1954).

As mentioned above, amounts distributed which are includible in the gross income of a beneficiary would, in general, not be taxable to the estate. This is accomplished by Section 661, which provides for a deduction, up to the estate's distributable net income, for amounts distributed to its beneficiaries. The language and framework of this section corresponds to that of Section 662. An estate can deduct amounts "required to be distributed currently" (first-tier distributions) under Section 661(a)(1), as well as "any other amounts properly paid or credited or required to be distributed" (second-tier distributions) under Section 661(a)(2).

The foregoing discussion of the distribution scheme of Subchapter J, although considerably simplified, provides an adequate framework within which to decide whether, as plaintiffs contend, the estate is entitled to a deduction under Section 661(a)(2) for the amounts paid to the Teagle Foundation. Both parties agree that the amount of the payments, although made to a charitable organization, are not deductible under Section 642(c) in computing the estate's taxable income. Mr. Teagle's will did not provide, as Section 642(c) requires, that the payments be made out of the estate's gross income. In fact, the payments here were made out of the corpus of the estate.

In addition, the parties seem to agree that none of the provisions of Section 663(a) expressly excludes the payments here from the operation of Section 661. The exception of Section 663(a)(1), for gifts or bequests of a specific sum or of specific property which is paid or credited all at once or in not more than three installments, is not applicable here because the bequest has not been satisfied in three installments or less. Moreover, it is not a bequest of a specific sum of money since its amount, expressed as a

percentage of the estate after payment of administrative expenses and other charges, was not ascertainable at the time of Mr. Teagle's death. *See* Treas. Reg. § 1.663(a)–1(b)(1) (1956). Section 663(a)(2), which provides that an estate may not deduct under Section 661 any amount paid, permanently set aside, or otherwise qualifying for the charitable deduction permitted by Section 642(c), would also seem to be inapplicable because the amounts here, as noted above, do not qualify under Section 642(c) for the charitable deduction.[14]

Plaintiffs contend that since none of the express exceptions to Section 661 applies here, the amounts paid to the Teagle Foundation are properly deductible under that section because they constitute "amounts properly paid • • • for such taxable year • • • ." The Government contends that "amounts" cannot be read literally and that Section 661(a)(2) does not apply to these charitable distributions. It relies principally on Section 1.663(a)–2 of the Regulations which provides in pertinent part:

> Any amount paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) and which is allowable as a deduction under that section is not allowed as a deduction to an estate or trust under section 661 or treated as an amount distributed for purposes of determining the amounts includible in gross income of beneficiaries under section 662. *Amounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates or trusts only as provided in section 642(c).* • • • [15]

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[14] Section 663(a)(3), which precludes a double distribution deduction where an amount required to be distributed is accumulated and distributed in a later year, is by its terms inapplicable to this case.

[15] Treas. Reg. § 1.663(a)-2 (1956) (emphasis added). *See also* Rev. Rul. 68–667, 1968–2 CUM. BULL. 289.

From our reading of this regulation, two things seem clear. First, the italicized language is dispositive of the issue in this case, since it prevents an estate from claiming as a deduction under Section 661(a)(2) any amounts distributed to a charitable beneficiary except as permitted by Section 642(c). Second, however, there is nothing in Section 663(a)(2), the statutory provision under which this regulation was promulgated, which expressly supports the rule announced in the regulation. Section 663(a)(2) provides only that an estate or trust may not deduct under Section 661 any amounts which are also deductible under Section 642(c); it does not specifically cover situations like the one here, where amounts paid to a charitable organization do not qualify for the charitable deduction.

The validity of this regulation must be sustained unless it is "unreasonable and plainly inconsistent with the revenue statutes • • • ." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). *See also, e.g., Estate of Bahen* v. *United States*, 158 Ct. Cl. 141, 145, 305 F. 2d 827, 829 (1962), and cases cited therein. After carefully considering the parties' contentions in this case, as well as the entire distribution scheme of Subchapter J, we think that the regulation is valid and also that any other rule would be an unreasonable interpretation of the statute.

We do not adopt plaintiff's argument that Section 661(a)(2) must be read according to its literal terms. If an estate were entitled to a distribution deduction for "*any* other amounts properly paid," as that section provides, then all payments made by an estate, whether or not to a beneficiary, would be deductible. For example, contrary to *Thomas Lonergan Trust*, 6 T.C. 715 (1946), an estate would be allowed a distribution deduction when it makes payments to a creditor in satisfaction of a judgment

against the estate. Moreover, under a literal interpretation of Section 661(a)(2), in many instances an estate would be entitled to a double deduction. Thus, expenses which are deductible under Section 212 would be deductible again under Section 661.

Obviously, the phrase "any other amounts paid" should not be read as broadly as its literal terms suggest. It must be interpreted in its own particular context, with reference to its relationship with the other provisions of Subchapter J, and in accordance with the consequences which Congress sought to achieve when it enacted Section 661 in 1954.

The most logical reference point in attempting to delineate the scope of Section 661 is the corollary provision of Section 662. That the two sections should be read together is not only implicit from the fact that they are similarly structured and in some instances identically worded, but also explicit from Section 662's express reference to Section 661. Thus, Section 662(a), in imposing its tax on distributees, states that "there shall be included in the gross income of a beneficiary to whom an amount specified in Section 661(a) is paid, credited, or required to be distributed * * * the sum of the following amounts * * *." By this reference, we think it is proper to confine Section 661 to distributions to *beneficiaries* of the estate, even though Section 661(a) does not specifically so provide.[16] Such a construction, implied in Section 662(a), prevents

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[16] This construction is confirmed by the legislative history of Section 661. *See* H.R. REP. No. 1337, 83d Cong., 2d Sess. A198 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 347 (1954):

"Section 661. Deductions for estates and trusts accumulating income or distributing corpus.

"This section (subject to the limitations discussed below) allows an additional deduction to estates or trust for amounts paid, credited, or required to be distributed *to beneficiaries.* * * * [Emphasis added]"

the absurd results mentioned above which would occur if the phrase "any other amounts properly paid" in Section 661(a)(2) were applied literally.

Of course, an interpretation which limits Section 661 to distributions to beneficiaries does not put an end to the matter here, since the Teagle Foundation is a beneficiary of the estate. Therefore, the Government also asks us to interpret Section 661(a) as permitting a deduction only for distributions to *taxable* beneficiaries, based upon its argument that Section 661 must be read as interdependent with Section 662. That is, as we understand the Government's argument, the incidence of the tax on the income of an estate must be allocated between estate and beneficiary, and to the extent that the beneficiary is exempt from the tax imposed by Section 662, any distributions to that beneficiary would not be deductible by the estate under Section 661.

The Government's position seems to be correct in the context of this case, but we do not hold that it is a general rule which may be applied in every conceivable situation that may arise under the provisions of the Code here considered. We think it is sufficient to say that, under the facts of this case, the Government's position accords with the general intent of Congress in enacting the distribution rules[17] and, as we discuss below, is in accord with what we believe to be an implied Congressional intent to prevent all charitable distributions, whether or not deductible under Section 642(c), from entering into the operation of the distribution rules.

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[17] *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 60 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 82 (1954):

"The bill adopts the general principle that to the extent of the trust's current income all distributions are deductible by the estate or trust and taxable to the beneficiaries."

As we noted above, when Congress enacted the present distribution rules its primary purpose was to eliminate the necessity for tracing the source of distributions. Under prior law, in general, beneficiaries were taxed only on amounts of current income distributed by an estate or trust. Such a simple rule led to manipulation,[18] and in 1942 Congress attempted to tighten up the statute by enacting the 65-day rules of Section 162(d) of the 1939 Code. The end result was that the distribution rules became so difficult to apply, and so entrenched in the tracing requirements, that Congress abandoned the old system in favor of the present scheme.[19] Tracing was eliminated by providing in Section 662 that all amounts distributed to beneficiaries would be considered to be distributions of income, subject to the modifications of Section 663 and the quantitative limitation of D.N.I. Consistent with the conduit principle, an estate or trust making such distributions would be entitled to a deduction under Section 661.

As we read Sections 661(a) and 662(a), Congress intended to do nothing more than combine the conduit principle with a conclusive presumption that distributions subject to the operation of those sections are distributions of income. Such a presumption is, we think, inapplicable to charitable distributions. As Section 642(c) provides, a charitable deduction is available only if the source of the distribution is gross income. Tracing of charitable distributions is still required under Section 642(c),[20] and to the

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[18] *See, e.g.*, Commissioner v. Dean, 102 F. 2d 699 (10th Cir. 1939).

[19] *See* Kamin, Surrey, & Warren, *The Internal Revenue Code of 1954: Trusts, Estates and Beneficiaries*, 54 COLUM. L. REV. 1237, 1246–48 (1954).

[20] Riggs National Bank v. United States, 173 Ct. Cl. 479, 352 F. 2d 812 (1965).

extent that a charitable distribution is not paid out of gross income in accordance with the requirements of Section 642(c), then we think that Congress intended that no deduction is allowable.

Without the distinction between charitable and noncharitable distributions, Congress' general intent in enacting the present provisions—to prevent manipulative distributions—would be seriously thwarted. The facts of this case are a good illustration. Both the Teagle Foundation and Jane, the sole income distributee, would be second-tier beneficiaries. If the estate could deduct under Section 661(a)(2) the payments made out of the corpus of the estate in satisfaction of the charitable bequest, then the following will result: the estate will pay no tax on the income which it accumulates, because that income will be offset by deductions for its distributions of corpus to the Teagle Foundation. Later on, the estate can distribute the accumulated income to Jane tax-free. With regard to current payments to Jane, concededly out of estate income, her tax would be greatly reduced. Thus, in 1963, she received $100,000 while the Teagle Foundation received approximately $13,200,000. If both amounts were considered distributions to beneficiaries within the meaning of Section 662, then Jane would be taxable on only 1/133 of the estate's D.N.I. for 1963, up to the amount of her distribution.

Based upon our reading of the distribution sections of Subchapter J and their legislative history, we conclude that Section 1.663(a)-2 of the Regulations, which provides that amounts distributed by an estate or trust to a charitable organization are deductible only under Section 642(c), is consistent with the statutory scheme and a reasonable interpretation thereof. It necessarily follows that plaintiffs are not entitled to a deduction pursuant to Section

661(a)(2) for the amounts of corpus distributed in satisfaction of the charitable bequest. Accordingly, defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed.

APPENDIX B

Statute and Regulation

Internal Revenue Code of 1954, as amended, 26 U.S.C., Vol. 6, at 6599-6604 (1971):

SECTION 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

* * *

(c) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

(1) GENERAL RULE.—In the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

* * *

SECTION 661. DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) DEDUCTION.—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

* * *

SECTION 662. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) INCLUSION.—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661(a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) AMOUNTS REQUIRED TO BE DISTRIBUTED CURRENTLY.—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642(c), relating to deduction for charitable, etc. purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount

of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) OTHER AMOUNTS DISTRIBUTED.—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

• • •

SECTION 663. SPECIAL RULES APPLICABLE TO SECTIONS 661 AND 662.

(a) EXCLUSIONS.—There shall not be included as amounts falling within section 661(a) or 662(a)—

(1) GIFTS, BEQUESTS, ETC.—Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

(2) CHARITABLE, ETC., DISTRIBUTIONS.—Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642(c) (computed without regard to sections 508(d), 681, and 4948(c)(4)).

(3) DENIAL OF DOUBLE DEDUCTION.—Any amount paid, credited, or distributed in the taxable year, if section 651 or section 661 applied to such amount for a preceding taxable year of an estate or trust because credited or required to be distributed in such preceding taxable year.

• • •

Treasury Regulation, 26 C.F.R., Part 1 (§1.641) at 52 (1971):

§1.663(a)-2. *Charitable, etc., distributions.*

Any amount paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) and which is allowable as a deduction under that section is not allowed as a deduction to an estate or trust under section 661 or treated as an amount distributed for purposes of determining the amounts includible in gross income of beneficiaries under section 662. Amounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates or trusts only as provided in section 642(c). For purposes of this section the deduction provided in section 642(c) is computed without regard to the limitation provided by section 681 (concerning unrelated business income and prohibited transactions).